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SUBJECT: BULGARIA: LEAN 2010 BUDGET AIMED AT ERM-II/ EUROZONE ENTRY

REFS: (A) SOFIA 698, (B) SOFIA 694, (C) SOFIA 666

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¶1. (SBU) SUMMARY: After successfully stabilizing a ballooning deficit in 2009, the Bulgarian government proposed a conservative 2010 budget in hopes of bolstering its credentials for ERM-II and eurozone membership. Approved by the Parliament on December 4, the government's final 2010 budget expects to run a 0.7 percent deficit based on a two percent drop in GDP, the lowest projected deficit in the EU. Overall revenues are expected to increase 1.7 percent over 2009 thanks to improved customs/tax enforcement, EU funds, and new taxes on cigarettes and gambling. Expenditures are set to rise 3.7 percent, but will be recalibrated to reflect national priorities. Expecting a continued rise in unemployment, the 2010 budget allocates more spending for social programs. EU funds will be channeled to large-scale public infrastructure and environmental projects. State administration and defense are slated for the largest cuts. Preliminary feedback from the IMF is positive. END SUMMARY.

New Government Stabilizes Unexpected 2009 Deficit

¶2. (SBU) After five straight years of budget surpluses and a projected surplus in 2009, the previous socialist-led government publically acknowledged the need to cut back on spending in early 2009 as aftershocks from the global financial crisis began to hit the Bulgarian economy. In reality, the government increased spending by over 500 million leva (USD 345 million) in the month of June alone as a last ditch effort to prevail in the July national elections. A fed-up and skeptical electorate was ultimately not convinced, and voted the center-right GERB party into power. Claiming it inherited an 11 percent deficit, the new government implemented supplementary measures to stabilize the budget, including freezing government salaries, downsizing government staff, suspending public contracts, and introducing customs and tax reforms to rein in spending and boost revenues. As a result, the government now expects to finish 2009 with a 0.8 percent deficit, projected to be lowest in the EU in an October 2009 European Commission report.

2010 Budget Maintains Fiscal Discipline

¶3. (SBU) Despite signs pointing to a global economic recovery, Finance Minister and former World Bank official Simeon Dyankov took a conservative approach in formulating the government's 2010 budget proposal. Approved by Parliament with little modification, the 2010 budget projects a 0.7 percent deficit (467 million leva or USD 322 million) based on a two percent drop in GDP. The European Commission expects Bulgaria to be the only EU country to post a deficit below three percent of GDP in 2010 (one of the four main Maastricht criteria). Menda Stoyanova, Chair of the Parliamentary Budget and Finance Committee, told us the strategic goal of the budget is to provide financial stability so that Bulgaria can join ERM-II and the eurozone as soon as possible.

¶4. (SBU) Compared to its revised 2009 budget, the government expects to increase revenues 1.7 percent to 26.4 billion leva (USD 18.2

billion) through strengthened customs/tax enforcement, improved absorption of EU funds, and higher taxes on cigarettes and gambling.

Expenditures will rise 3.7 percent to 26.9 billion leva (USD 18.5 billion). If the economy performs below official expectations in 2010, the budget legislation allows the Council of Ministers to further restrict national and municipal administrative costs.

15. (SBU) The budget passed parliament with the support of GERB's informal coalition partners, the Blue Coalition and Ataka. The main opposition parties, BSP and MRF, voted against the budget on the grounds that it was too conservative. They specifically argued that the government had underestimated economic growth in 2010 to the detriment of spending on social programs. They also criticized the government's budget for lowering revenues and expenditures compared to the former government's original 2009 budget.

Priorities: Social Programs, the Environment, and Infrastructure

16. (SBU) Anticipating a rise in the unemployment rate to 11.5 percent, the government has budgeted a 7.8 percent increase in spending on social programs. That said, funding for some employment programs has been cut by 13.8 percent and pension payments will only increase if a surplus materializes in the second half of 2010. Also considered priorities, education and health care spending will see nominal increases and remain constant as a measure of GDP. If EU structural funds are successfully absorbed, spending on environmental protection will jump 20 percent to 990 million leva (USD 680 million). EU assistance will also be used to increase spending on major infrastructure projects such as three international highways (Ref A).

Losers Include State Administration and Defense

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17. (SBU) Continuing the revised 2009 budget's strategy, the Bulgarian government plans to further downsize administration costs, especially for government staff. The defense ministry will be particularly hard hit with an expected 10.3 percent cut compared to the revised 2009 budget. In other terms, Bulgaria's 2010 defense spending will drop to 1.4 percent of GDP, well below the NATO target of two percent.

COMMENT

18. (SBU) The IMF's local representative privately assessed revenue and spending expectations as reasonable, and in line with next year's growth projections. The IMF plans to release an official analysis of Bulgaria's budget before the end of the year. This budget, bordering on austere, shows that the new government is serious about putting Bulgaria's fiscal house in order and focusing on what it calls its number one foreign policy priority, early acceptance to ERM-II and the eurozone.